91-651

No.

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1991

DIANA T. VORSHECK
JOHN P. VORSHECK
Petitioners-Appellants

- versus -

COMMISSIONER OF INTERNAL REVENUE SERVICE
Respondent-Appellee

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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QUESTIONS PRESENTED FOR REVIEW

1. WHETHER THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT ERRED AND WAS INCONSISTENT IN AFFIRMING THE TAX COURT'S DECISION TO UPHOLD THE COMMISSIONER'S DETERMINATION OF A DEFICIENCY WITH INTEREST IN THE PETITIONERS' TAXES ALTHOUGH THE SAME COURT REVERSED THE COMMISSIONER'S ASSESSMENT OF PENALTIES BASED ON DETERMINATION IN HEASLEY, 902 F. 2d AT 386 WHICH REVERSED PENALTIES AND INTEREST.

2. WHETHER IN THIS INSTANCE THE TAX LAW PROVIDES THE TAXPAYER WITH AN OPPORTUNITY FOR EQUAL JUSTICE UNDER THE LAW.

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CASES

No.

IN THE
SUPREME COURT OF THE UNITED STATES

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DIANA T. VORSHECK JOHN P. VORSHECK	Petitioners- Appellants

- versus -

COMMISSIONER OF INTERNAL REVENUE SERVICE	Respondent- Appellee

Petition for Writ of Certiorari to the
United States Court
of Appeals for the Ninth Circuit

Diana T. Vorsheck and John P. Vorsheck petition for a writ of certiorari to review the order of the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

The order of the United States Court of Appeals for the Ninth Circuit (Diana T. Vorsheck & John P. Vorsheck v. Commissioner of Internal Revenue Service, No. 90-70266; Tax Court No. 23532-86, Appendix 9a) is published.

JURISDICTION

The order of the United States Court of Appeals for the Ninth Circuit sought to be reviewed was submitted on May 9, 1991 and filed May 16, 1991 (Appendix at 1a). Petitioners request for rehearing with a suggestion for rehearing en banc was denied by order of the United States Court of Appeals for the Ninth Circuit filed July 18, 1991 (Appendix at 8a).

The jurisdiction of this court is invoked to review the order of the United States Court of Appeals for the Ninth Circuit pursuant to Article III Section 2 of the Constitution of the United States (Appendix at 10a).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

ARTICLE III.

The Judicial Branch

"Section 2. (1) The Judicial power shall extend to all cases, in law and equity, arising under this Constitution, the laws of the United States, and treaties made, or which shall be made, under their authority;..."

The right of the federal courts to handle "cases arising under this Constitution" is the basis of the Supreme Court's right to declare laws of Congress unconstitutional. This right of "judicial review" was established by Chief Justice John Marshall's historic decision in the case of Marbury v. Madison.

AMENDMENT I

Rights of Assembly and Petition

Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the government for a redress of grievances.

Congress also may not keep people from asking the government for relief from unfair treatment.

AMENDMENT XIV

Civil Rights

Section I. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

STATEMENT OF THE CASE

Petitioners invested in Western Reserve Oil and Gas Company Limited Partnership in November 1982. The investment was presented as a conservative oil and gas program with only one objective: to produce income by drilling for oil. Based on the substance of the leases, the Partnership had acquired and further intended to obtain, the objectives seemed feasible.

Petitioners, on their tax return, claimed their distributive share of partnership business deductions, credits, abandonment losses from dry wells and interest expenses as presented on Schedule K-1 Form 1065).

Petitioners were subsequently advised by the Internal Revenue Service on April 11, 1984 that the partnership's activities

were being examined and that deductions and/or credits might not be allowed and that their return would be examined.

Subsequently, in January 1986, petitioners were asked to sign consent Form 872A and return same within ten days. This extended the statute of limitation period, which was about to expire, prescribed by law for assessing additional tax.

After receiving a notice of deficiency April 10, 1986 petitioners filed a timely petition to the United States Tax Court on June 27, 1986. Petitioners requested that deductions be allowed as claimed and that all penalties and interest assessed by the Internal Revenue Service be eliminated. Petition was answered September 8, 1986.

Petitioners tried repeatedly to meet with someone from the Internal Revenue Service to discuss some settlement or have

the case set for trial in a timely manner. Instead, petitioners were sent several conflicting "final offers" from the Internal Revenue Service all indicating that the "government would prevail." Amounts owed varied depending on the "offer" received.

February 1, 1988 the case was assigned to Judge Featherston in Los Angeles Tax Court and October 2, 1989 a court order set trial for February 12, 1990.

Commissioner filed a motion November 27, 1989 for order to show cause why judgment should not be entered against petitioners on basis of Ferrell case. Petitioners filed timely response on January 23, 1990 and trial before Judge Featherston commenced on February 12, 1990. (Four years after initial request.)

March 16, 1990 a decision was entered by Judge Featherston that petitioners were not liable for the addition to tax for negligence and they did not have any additional liability under Section 6659. Petitioners were held liable for the deficiency as determined and addition to tax under Section 6661(a) in the amount of 10% (Appendix 15a).

A notice of appeal was filed by petitioners on May 8, 1990 to the United States Court of Appeals Ninth Circuit and reply brief for the petitioners was filed on October 24, 1990 in a timely manner.

May 9, 1991 the opinion of the Ninth Circuit Court of Appeals was published. It was shown that the petitioners were acting as "an ordinary prudent person in the circumstances," that their reliance upon the investment advice of their accountant was "reasonable" and "in good faith under

all circumstances." See Treas. Reg. #1-6661.6(b); Heasley, 902 F.2d at 385, petitioners met the standard for waiver of the penalty under Section 6661. The Tax Court's decision upholding the Commissioner's assessment of a 10% penalty under Section 6661 was reversed (Appendix 6a-7a).

Petitioners timely filed a petition for rehearing with a suggestion for rehearing en banc. It was stated that several material points of fact were not adequately determined nor scrutinized in Ferrell nor subsequent to Ferrell that the investment Western Reserve Oil and Gas produced income, which had been verified by Trustee's reports and overlooked by the courts, raising the issues of profit motive as determined in Mertens Law of Federal Taxation (Appendix 17a-20a), and that in Heasley v. Commissioner 902 F. 2d 380, (5th Cir., 1990) taxpayers were not subject

to penalties nor interest. The petition for rehearing was denied on July 18, 1991 (Appendix 8a) and mandate issued September 18, 1991.

REASONS FOR GRANTING WRIT

Several important and special reasons exist for granting review of the order of the United States Court of Appeals for the Ninth Circuit.

(1) The United States Court of Appeals for the Ninth Circuit reversed the Tax Court's decision upholding the Commissioner's assessment for a 10% penalty under Treasury Regulation ~ 1.6661-6(b). according to Heasley v. Commissioner, 902 F.2d 380, 386, but makes no mention of interest. However, the United States Court of Appeals, Fifth Circuit in deciding Heasley clearly states in conclusion,

> "The IRS should not exact every penalty possible in every case where taxpayers pay less than the full amount of tax due. Here, on rather questionable facts, the IRS did just that. This case simply does not support such draconian efforts. Therefore, we Reverse the decision of the tax court and the IRS's assessment of penalties and interest."

Petitioners (Vorsheck's) were found to have acted "in good faith under all circumstances." (Appendix 6a)

(2) In Heasley v. Commissioner, the Heasley's invested in O.E.C. Leasing Corporation, an energy conservation program which never generated any income, whereas Western Reserve Oil and Gas did generate income even in Chapter 11 as evidenced by the last known United States Trustee interim report from October 2, 1989. The West Virginia wells alone generated $134,596.85 in 1987 and $84,082.75 in 1988 for Western Reserve Oil and Gas. The sale of wells to Key Oil generated $405,000.00 in a secured note and cash in 1990, verified by counsel for the United States Trustee for Western Reserve Oil and Gas.

(3) The Internal Revenue Service intentionally delayed the hearing for petitioners to await the outcome of Ferrell

v. Commissioner, 90 T.C. 1154 (1988). Due to this delay, interest at this time exceeds the amount of the tax deficiency by almost 200%. This is clearly abuse of discretion on the part of the Commissioner. The Internal Revenue Service should not be allowed to unjustly enrich itself due to its own delay and ineffiency which causes undo hardship on the taxpayer.

Although requested repeatedly by petitioners, through offices in Detroit, Laguna Niguel and San Diego, at no time prior to the Tax Court proceedings were they allowed to meet with anyone at the Internal Revenue Service to try to reach a settlement. (See: Department of the Treasury Internal Revenue Service, Publication 5 (Rev. 8-84) "Appeal Rights and Preparation of Protests for Unagreed Cases."

"If You Don't Agree"

"If you decide not to agree with the examiner's findings, you have the option of requesting a meeting with the examiner's supervisor to discuss the findings. If you still do not agree, we urge you to appeal your case with the Service. Most differences can be settled in these appeals without expensive and time-consuming court trials."

(4) Material points of fact were not adequately determined nor scrutinized in Ferrell nor subsequent to Ferrell in the Tax Court and United States Court of Appeals for the Ninth Circuit.

The IRS seized documents from Western Reserve Oil and Gas and transcripts were destroyed in the U. S. Trustees office in Santa Ana , CA which were pertinent to the determination of a factual issue, namely income. Most recently, petitioner was denied access to files in the United States Trustee's office in Santa Ana, CA.

The United States Trustee for Western Reserve Oil and Gas operated as debtor-in-possession for over thirty-two months without fully complying with the United States Trustee Requirements. No quarterly reports were issued after October 2, 1989.

Attorneys for the United States Trustee, R. Neil Rodgers, would not produce any existing well information, nor income statements claiming attorney/client privilege.

The United States Trustee, R. Neil Rodgers, has now resigned his position from Western Reserve Oil and Gas.

(5) In May, 1990 the Internal Revenue Service sent two separate settlement checks to the United States Trustee for Western Reserve Oil and Gas in the amounts of $103,691.79 and $105,612.48 respectively. The Internal Revenue Service

had seized bank accounts from Western Reserve Oil and Gas prior to the Ferrell decision in 1988. Western Reserve v. I.R.S. in District Court, Los Angeles settled three cases prior to trial, verified by counsel for the U. S. Trustee out of court. These funds, having been seized in error, were refunded to the estate of Western Reserve subsequent to the Ferrell decision which was mainly based on profit motive at the partnership level. This would also affect petitioners' obligation to pay any tax deficiency.

It was the opinion of the United States Tax Court, "based upon the testimony which I (Judge Featherston) heard over a period of many days, and based on the examination of numerous documents which were introduced in evidence at that trial, Western Reserve Oil & Gas was an egregious tax shelter." (Appendix T.C. 3/16/90

opinion 14a) This is opinion only. The existence of these funds from the Internal Revenue Service was only made known to the petitioners after they stated that witnesses and records would be subpoenaed from the United States Trustee for non-disclosure. These documents were not available at the Ferrell hearing.

(6) Congress has placed the United States in a state of severe monetary deficit. In a telephone conversation with Dwight R. Schockney, counsel for the Commissioner of the Internal Revenue Service, petitioner was told the following, paraphrased:

"That there was no one petitioners might speak with and that there could be no thought to an offer in compromise. The government relies on these funds from taxpayers to function, and although the tax

law seems unfair, that's just the way it is. It is a unilateral situation and the Supreme Court supports this position."

This then would not be "equal justice under law", a fundamental right, which graces the entrance to the Supreme Court. The Taxpayers' Bill of Rights needs to be enforced so that our country can benefit from budget and tax reform.

We pray the Supreme Court to reverse the interest charges imposed by the Internal Revenue Service and to take judicial notice of these inequities and inconsistencies and consider a writ of certiorari on behalf of petitioners. Thank you.

CONCLUSION

Petitioners respectfully request that the petition for writ of certiorari be granted.

Respectfully submitted,

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October, 1991

APPENDIX

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

DIANA T. VORSHECK; JOHN P. VORSHECK,
Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE SERVICE,
Respondent-Appellee.

No. 90-70266

Tax Ct. No. 23532-86

OPINION

Appeal from a Decision of the
United States Tax Court

Submitted May 9, 1991*

Filed May 16, 1991

Before: James R. Browning, Alfred T. Goodwin and Cecil F. Poole, Circuit Judges.

Per Curiam

SUMMARY

Income Taxes

Affirming in part and reversing in part a decision of the U.S. Tax Court, the court of appeals held that taxpayers who had invested in a limited partnership were not liable for a tax

*The panel finds this case appropriate for submission without oral argument pursuant to Ninth Circuit Rule 34-4 and Fed. R. App. P. 34(a).

underpayment penalty because they reasonably and in good faith relied on the advice of their accountant under the circumstances.

The tax court upheld the Commissioner of Revenue's disallowance of a deduction for losses incurred by appellants John P. and Diana T. Vorsheck as a result of their investment in a limited partnership. In addition, the tax court upheld the 10% penalty for substantial understatement of income tax under 26 U.S.C. § 6661.

[1] Section 162 of the Internal Revenue Code allows deductions for all ordinary and necessary expenses paid or incurred in carrying on any trade or business. However, before a deduction is allowed, it must be shown that the business activity was entered into with the dominant hope and intent of realizing a profit. Vorsheck had to show that the activity was entered into with a profit motive. When the profit motive of a limited partnership is at issue, the tax court makes its determination of profit at the partnership level. **[2]** The law in the Ninth Circuit is well settled that profit motive is determined at the partnership level. Although the Vorshecks may have invested in the limited partnership with the intent of realizing a profit, they were bound by the motive of the partnership. Accordingly, the tax court's decision upholding the additional tax deficiency was affirmed.

[3] The Vorshecks argued that even if they were liable for the deficiency, they acted reasonably and in good faith and therefore were not liable for a penalty under section 6661. The Secretary may waive the penalty on a showing by the taxpayer that there was reasonable cause for the understatement and that the taxpayer acted in good faith. **[4]** If it was reasonable for the taxpayer to rely upon the advice of an accountant under the circumstances, and the taxpayer did so in good faith, then the Commissioner may waive the penalty. **[5]** Here, the tax court found that, although the fact that the business venture was a tax shelter would have been apparent to an

"experienced businessman," the Vorshecks were not sophisticated business persons. They relied upon the advice of their trusted tax adviser who assured them that they would obtain certain deductions. **[6]** The court concluded that if the Vorshecks were acting as ordinary prudent persons in the circumstances, then their reliance upon the investment advice of their accountant was reasonable and in good faith. Thus, the court reserved the tax court's decision upholding the Commissioner's assessment of a penalty.

COUNSEL

Diana Vorsheck and John P. Vorsheck, Laguna Hills, California, pro se for the petitioners-appellants.

Shirley D. Peterson, Tax Division, United States Department of Justice, Washington, D.C., for the respondent-appellee.

OPINION

PER CURIAM:

Diana Todaro Vorsheck and John P. Vorsheck appeal pro se the tax court's decision upholding the Commissioner of Internal Revenue's ("Commissioner") determination of a tax deficiency of $10,910 for the 1982 tax year. The tax court upheld the Commissioner's disallowance of a deduction for losses incurred through their investment in Western Reserve Oil & Gas Co., Ltd. ("WROG"), a limited partnership, because WROG did not have a profit motive. In addition, the tax court upheld the 10% penalty for substantial understatement of income tax pursuant to 26 U.S.C. § 6661. The Vorshecks contend that they invested in WROG with an intent to make a profit, and that they should not be liable for the penalty under section 6661 because they acted reasonably in their

investment. We have jurisdiction pursuant to 26 U.S.C. § 7482, and affirm in part, reverse in part.

The tax court's rulings of law are reviewable de novo. *Vukasovich, Inc. v. Commissioner*, 790 F.2d 1409, 1413 (9th Cir. 1986). The issue of whether the Vorshecks invested in WROG with the requisite profit motive is a finding of fact reviewable for clear error. *Baxter v. Commissioner*, 816 F.2d 493, 495-96 (9th Cir. 1987).

I

Deficiency Determination

[1] Section 162 of the Internal Revenue Code ("Code"), 26 U.S.C. § 162, allows deductions for all ordinary and necessary expenses paid or incurred in carrying on any trade or business. Section 167 of the Code allows a depreciation deduction for property used in trade or business. 26 U.S.C. § 167. Before a deduction is allowed under these sections, "it must be shown that the activity was entered into with the dominant hope and intent of realizing a profit." *Brannen v. Commissioner*, 722 F.2d 695, 704 (9th Cir. 1984). The petitioner has the burden of showing she entered into the transaction with a profit motive. *Baxter*, 816 F.2d at 495. When the profit motive of a limited partnership is at issue, the tax court makes its determination of profit at the partnership level. *Polakof v. Commissioner*, 820 F.2d 321, 323 (9th Cir. 1987).

[2] In *Ferrell v. Commissioner*, 90 T.C. 1154, (1988), the tax court found that WROG did not have a profit motive, did not engage in a trade or business, and was carried on to enrich its organizers and offer investors a tax shelter. *Id.* at 1198-99. The law in the Ninth Circuit is well settled that profit motive is determined at the partnership level. *See Polakof*, 820 F.2d at 323. Although the Vorshecks may have invested in WROG with the intent of realizing a profit, they are bound by the motive of the partnership, as determined in *Ferrell*. Thus, the

tax court correctly decided that the Vorshecks failed to distinguish their case from *Ferrell*. Accordingly, we affirm the tax court's decision upholding the Commissioner's determination of a $10,910 deficiency in the Vorshecks's taxes for the 1982 tax year.

II

Section 6661 Penalty

[3] The Vorshecks argue that even if they are liable for the deficiency, they acted reasonably and in good faith and therefore should not be liable for a penalty under 26 U.S.C. § 6661.[1] Section 6661 provides that if there is a substantial understatement of income taxes, a penalty of 10 percent of the amount of the understatement shall be added to the tax. 26 U.S.C. § 6661(a). An understatement is substantial if it exceeds $5,000 or 10 percent of the income tax for the taxable year. 26 U.S.C. § 6661(b)(1)(A). Section 6661(c) provides that the Secretary may waive the penalty "on a showing by the taxpayer that there was reasonable cause for the understatement . . . and that the taxpayer acted in good faith."

[4] According to the Treasury Regulations promulgated under this statute:

> Reliance on an information return or on the advice of a professional (such as an appraiser, an attorney, or an accountant) would not necessarily constitute a showing of reasonable cause and good faith. . . . Reliance on an information return, professional advice, or other facts, however, would constitute a showing of reasonable cause and good faith if, under all the circumstances, such reliance was reasonable and the taxpayer acted in good faith.

[1]The tax court found that because the Vorshecks were not negligent, they were not liable for penalties or additions to tax under section 6653 or section 6659.

Treas. Reg. § 1.6661-6(b). Thus, if it was reasonable for the taxpayer to rely upon the advice of an accountant under the circumstances, and the taxpayer did so in good faith, then the Commissioner may waive the penalty. *See also Heasley v. Commissioner*, 902 F.2d 380, 383 (5th Cir. 1990) (couple with no advanced business experience or sophisticated business knowledge who invested in tax shelter on the advice of their financial advisor were not liable for penalty under section 6661 because, "[g]iven [their] inexperience and limited knowledge about investing, and their level of education, their misunderstanding is reasonable" and the penalty should be waived)

[5] Here, the tax court found that, although the fact that WROG was a tax shelter would have been apparent to an "experienced businessman," the Vorshecks were not sophisticated business persons.[2] "[T]hey relied upon the advice of their trusted tax adviser who assured them that they would obtain certain deductions."

[6] On the basis of its evaluation of the motives and experience of the Vorshecks, the tax court denied the penalties under sections 6653 and 6659. The tax court, however, found that the Vorshecks were liable for the penalty under 6661. We do not agree. If the Vorshecks were acting as "an ordinary prudent person in the circumstances," then their reliance upon the investment advice of their accountant was "reasonable" and "in good faith under all the circumstances." *See* Treas. Reg. § 1-6661.6(b); *Heasley*, 902 F.2d at 385. Thus, the Vorshecks meet the standard for waiver of the penalty under sec-

[2]The tax court found:

> Petitioners in this case did not have that kind of business experience. They knew nothing about the tax laws. They relied upon their advisor. They knew nothing about the circumstances in which they would be expected to obtain special advice. In my judgment, they acted as an ordinary prudent person in the circumstances.

tion 6661. Accordingly, we reverse the tax court's decision upholding the Commissioner's assessment of a 10% penalty under section 6661.

AFFIRMED IN PART, REVERSED IN PART.

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

DIANA T. VORSHECK; JOHN P. VORSHECK	)	No. 90-70266 Tax Ct. No. 23532-86
Petitioners-Appellant	)	
v.	)	ORDER
COMMISSIONER OF INTERNAL REVENUE SERVICE,	)	
Respondent-Appellee.	)	

Before: BROWNING, GOODWIN AND POOLE, Circuit Judge.

The panel has voted unanimously to deny the petition for rehearing. Judges Browning and Poole have voted to reject the suggestion for rehearing en banc, and Judge Goodwin so recommends.

The full court has been advised of the suggestion for rehearing en banc and no active judge has requested a vote on whether to rehear matter en banc. Fed. R. App. 35(b).

The petition for rehearing is DENIED and the suggestion for rehearing en banc is REJECTED.

Filed: July 18, 1991 Cathy A. Catterson, Clerk U.S. Court of Appeals

UNITED STATES TAX COURT
WASHINGTON, D.C. 20217

DIANA TODARO VORSHECK AND JOHN P. VORSHECK Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent.	)	Docket No. 23532-86

ORDER

Upon due consideration of the decision of the U.S. Court of Appeals for the Ninth Circuit affirming in part and reversing in part the decision of the Tax Court, it is

ORDERED that this case is assigned to Judge C. Moxley Featherston for purposes of proceeding pursuant to the mandate.

(Signed) Arthur L. Nims, III

Chief Judge

Dated: Washington, D.C.
September 19, 1991

Article III Section 2
Constitution of the United States

Article III
The Judicial Branch

Section 2.(1) "The judicial power shall extend to all cases, in law and equity, arising under this Constitution, the laws of the United States, and treaties made, or which shall be made, under their authority;...."

The right of the federal courts to handle "cases arising under this Constitution " is the basis of the Supreme Court's right to declare laws of Congress unconstitutional. This right of "judicial review" was established by Chief Justice John Marshall's historic decision in the case of Marbury v. Madison.

UNITED STATES TAX COURT

WASHINGTON D.C. 20217
March 9, 1990

DIANA TODARO VORSHECK and JOHN P. VORSHECK,	)	
Petitioners	)	Docket No. 23532-86
v.	)	
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent	)	

NOTICE OF SERVICE OF TRANSCRIPT

Pursuant to Rule 152(b), Rules of Practice and Procedure of this Court, there is transmitted herewith to petitioners and to respondent a copy of the pages of the transcript of the trial in the above case before Judge C. Moxley Featherston, at Los Angeles, California, on February 12, 1990, containing his oral findings of fact and opinion rendered at the conclusion of the trial.

In accordance with the oral findings of fact and opinion, a decision will be entered.

Charles S. Casazza
Clerk of the Court

Bench Opinion by Judge C. Moxley Featherston
Docket Number 23532-86 February 12, 1990

THE COURT; I have decided to enter a bench opinion in this case and the following is my bench opinion.

Section 6653 (a)(1) calls for the imposition of an addition to tax in the amount of five per cent if any part of an underpayment is due to negligence.

Section 6653 (a)(2) provides for a further addition with respect to the portion of the underpayment which is attributable to negligence.

In determining whether a person is negligent in the preparation and filing of his income tax return, the standard is what an ordinary, prudent person in similar circumstances would do. In deciding what an ordinary and prudent person would do, we have to recognize that the term

"prudent person" is elastic. We look at the circumstances of the individual person to ascertain what standard to apply. The term "prudent person", referring to an individual with large investments, well versed in the business world and with a full knowledge of the law, would be expected to know more than one with less experience and less background. A businessman or lawyer of such experience would be expected also to know when to obtain advice and counsel with respect to the filing of his tax return.

In this case, the record shows that John P. Vorsheck and Diana Vorsheck were induced to invest in the Western Reserve Oil and Gas Company by an individual whom they had known and trusted for some time. John was a salesman and Diana was a travel consultant.

They had a total income of only $38,000 from those sources. In deciding whether to make this investment, they relied upon the advice of their trusted tax adviser who assured them that they would obtain certain deductions. They had relied upon that individual for a number of years and had trusted him. They did not seek a second opinion.

In my opinion, based upon the testimony which I heard over a period of many days, and based on the examination of numerous documents which were introduced in evidence at that trial, Western Reserve Oil and Gas was an egregious tax shelter. Any experienced businessman in my judgment who took the time to analyze that setup would have recognized that it was without economic reality. But Petitioners in this case did not have that kind of business experience.

They knew nothing about the tax laws. They relied upon their advisor. They knew nothing about the circumstances in which they would be expected to obtain special advice. In my judgment, they acted as an ordinary prudent person in the circumstances and the addition to tax under Section 6651(a)(1) and (a)(2) is not applicable. Petitioners are liable for the deficiency as determined. They are not liable for the addition to tax for negligence and consistent with the Ferrell opinion, they do not have any additional liability under Section 6659. A decision will be entered consistent with this holding.

In addition, Petitioners will be liable for the addition to tax under Section 6661(a) in an amount of ten percent.

(Bench Opinion concluded at 3:42 p.m.)

UNITED STATES TAX COURT

Washington, D.C. 20217

DIANA TODARO VORSHECK and JOHN P. VORSHECK	)	
Petitioners	)	Docket No. 23532-86
v.	)	
COMMISSIONER OF INTERNAL REVENUE	)	
Respondent	)	

DECISION

Pursuant to the bench opinion entered in this case on February 12, 1990, it is

ORDERED and DECIDED that there is a deficiency in petitioners' income tax for 1982 in the amount of $10,910.00; that petitioners are not liable for any additions to tax under section 6659, or under section 6653(a)(1) and (2); and that petitioners are liable for an addition to tax under section 6661(a) in the amount of $1,091.00

(Signed) C. Moxley Featherston
Judge

Entered: March 16, 1990

MERTENS LAW OF FEDERAL INCOME TAXATION

Chapter 28.53. Profit Motive. p.164

The deductibility of losses incurred in transactions entered into for profit depends on "whether the taxpayer's motive in entering into the transaction was primarily profit. The factors considered in determining intent are similar to those considered in connection with hobby losses.

Intent, Not Realistic Prospect, Required p.165

While the expectation of profit need not be a reasonable one, and the business need not realize an immediate profit, the activities must be entered into and carried on in good faith for the purpose of making a profit.

To state the proposition differently, each taxpayer is entitled to conceive and embark on his own enterprise, no matter how impractical, idiosyncratic or questionable of success it may seem to others. Even though the prospects of profitable operations are negligible or even absent, that alone is not conclusive in determining the taxpayer's purpose.

Profit Motive Motive Must Be Primary Motive p.166

It is not necessary that the taxpayer be actuated solely by profit motives or intentions, but the profit motive must be the primary one. Though it is ordinarily reasonable to assume that businessmen do not undertake a commercial venture except for the purpose of making profit and that, in such a situation, although they may

exercise bad judgment so that the prospects of a profitable operation are negligible or even absent, that alone would be an inadequate criterion for determining the taxpayer's purpose.

Profit Need Not Be Immediate p.167

It is not necessary that the taxpayer make an immediate profit if he establishes that he expected to make a profit within a reasonable time period.

Chapter 28.70 Unforeseen Circumstances p.214

If losses are sustained because of unforeseen or fortuitous circumstances which are beyond the taxpayer's control, no indication of an objective other than profit need be inferred. Such unforeseen or fortuitous circumstances include:

(6) involuntary conversion

(7) depressed or saturated market conditions

Chapter 28.71 Profit Record p. 215

An occasional small profit from an activity generating large losses, or from an activity in which the taxpayer made a large investment is generally not determinative on the question of whether an activity is engaged in for profit. Moreover, an opportunity to earn a substantial ultimate profit in a highly speculative venture is ordinarily sufficient to indicate that the activity is engaged in for profit even though losses or occasional small profits are actually generated.

Profit in Other Years

Assuming a taxpayer cannot satisfy the profit presumption, courts are generally

willing to look at years other than the years at issue to determine whether the taxpayer had a profit objective.